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C O N F I D E N T I A L SECTION 01 OF 03 BUDAPEST 000725

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SUBJECT: PREPARATIONS UNDERWAY FOR PAKS NUCLEAR EXPANSION

REF: BUDAPEST 338

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Classified By: Economic Officer Jeffrey M. Jordan, reasons 1.4 (b),(d)

11. (C) Summary: Work on the possible expansion of Hungary's Paks Nuclear Plant proceeds apace as experts work to define Hungary's power generation needs in the coming decades and potential suppliers begin their marketing efforts. The tender is expected to occur sometime in early 2011. Political considerations are likely to play into the final decision on who will provide the new reactors and, accordingly, European and Russian diplomatic efforts are already underway to support their respective national champions. Westinghouse, the U.S. company likely to bid in the tender, plans to apply with the Embassy's Commercial Section for advocacy (strictly protect). End summary.

12. (U) Econoff and two representatives from the Embassy's Commercial Section recently paid a visit to Hungary's Paks Nuclear Power Plant, where Senior Technical Advisor Andras Cserhati gave an overview of progress toward expanding the plant's capacity. Parliament gave its near unanimous approval last spring for the state-owned MVM to initiate preparatory work toward increasing the capacity of its nuclear plant (reftel).

PAKS EXPANSION GEARED TO FILL PROJECTED SUPPLY GAP

13. (SBU) After describing nuclear energy's important role in Hungary's energy mix, roughly one-third of Hungary's electricity in 2008, Cserhati made a case for expanding Hungary's nuclear power capacity based on the need to replace aging conventional capacity, mainly coal- and oil-based, and meet growing electricity demand. Prior to the economic downturn, MVM/Paks forecasted annual demand growth of 2 percent per year, implying a need for roughly 7000MW of new capacity by 2025. The company's revised projections show demand growing at 1.5 percent per year and a need for 6000MW of new capacity in the same timeframe. Hungary's installed capacity is currently about 9000MW. According to Cserhati, non-industrial electricity consumption is the primary driver

of this projected demand growth. (Comment: It was not clear if these projections took account of the currently planned 6-8000MW of private sector investment in conventional generating capacity. Moreover, a forecast of 1.5-2 percent annual demand growth through 2025 seems out of sync with ongoing trends in Hungary toward energy efficiency and conservation, not to mention Hungary's declining population. End comment.)

14. (SBU) According to Cserhati, Hungary wishes to install one or two light/pressurized water reactors with a 60-year lifespan and a load following capacity of 50-100 percent (i.e., able to power down to 50 percent capacity). He emphasized that Hungary is not interested in purchasing "first-of-a-kind" technology. Based on these criteria, Cserhati listed four models most likely to be invited to participate in the tender: U.S. Westinghouse's AP1000, Russian Atomstroyexport's AES-92, French-German Areva's EPR, and possibly AREVA-MHI's ATMEA1. (Comment: Hungary's insistence on a proven technology would seem to automatically exclude the European-Japanese ATMEA1, for which there is not yet even a working prototype. End comment.) Cserhati indicated that Hungary had to forego its initial interest in a smaller 600MW reactor design as the industry shifted focus toward larger capacity reactors. Allowing that "what we need is one thing, what is on offer is another," Cserhati said authorities would now have to choose from among the 1000MW reactors offered by the U.S. and Russian suppliers and AREVA's 1600MW behemoth.

15. (SBU) Responding to Econoff's question about a possible oversupply of electricity in Central and Eastern Europe, given well-advanced plans by many of Hungary's neighbors to build new nuclear capacity, Cserhati said that Hungary is

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pursuing its own nuclear plans in the context of a wider effort to integrate the region's electricity market. Cserhati conceded that, in addition to integrating the physical grid infrastructure, the development of an effective regional market would also require some degree of harmonization of the countries' regulatory regimes. He was not able to provide details on progress in this area, but he emphasized that a decision to construct new reactors would be based on regional demand projections and indicated that projected electricity shortages in the Balkans might help justify the new capacity.

POTENTIAL INVESTORS QUEUING UP

16. (SBU) Cserhati echoed our previous interlocutors in claiming that the Paks expansion would be accomplished "on a business basis," without tapping government budget resources, though he conceded that a government guarantee might be necessary for at least a portion of the debt. Based on his cost estimate of 3 billion euro (\$4.4 billion) per 1000MW reactor and 19 billion HUF (\$102 million) to cover the grid upgrades needed to accommodate an additional 2000MW of power, the price tag for two new reactors is likely to approach \$9 billion.

17. (SBU) MVM/Paks hopes to attract funding from a combination of financial investors and strategic investors. Financial investors might include international commercial banks, export credit financing agencies, the capital markets, and international financial institutions such as the World Bank and the EBRD. Strategic investors could include companies with experience operating, constructing or investing in nuclear plants; electricity dealers; network operators; and large base load consumers. According to Cserhati, one or two strategic investors would most likely take a minority equity stake--the Hungarian state plans to retain majority ownership via its ownership of MVM. He added that Paks is already in discussions with several interested parties, including Russia's Atomstroyexport, Germany's E.ON and RWE, France's EDF, Switzerland's Atel, and Finland's Fortum.

THE TENDER IS STILL 12-18 MONTHS AWAY...

¶8. (SBU) Cserhati, who also serves as chairman of the working group responsible for organizing the tender, expects to begin evaluating bids from the companies invited to participate sometime in early 2011, with a goal to bring the first new reactor online by 2020 and the second by 2025. The bid requirements will be in accordance with the European Utility Requirements and MVM/Paks has engaged the advisory services of KPMG's Central and Eastern European Energy & Utility division.

¶9. (SBU) In an effort to begin seriously evaluating the reactor options before them, Paks experts have begun consulting with counterparts in neighboring countries such as the Czech Republic, Slovakia, and Slovenia, where plans are also underway to expand nuclear capacity. A series of conferences around the region organized by think tanks and potential suppliers alike, including one Westinghouse hosted in Bratislava last month, is allowing vendors to bolster their marketing and outreach efforts. Paks plans to host its own conference soon (no further information) where it will more fully define its preferences to potential suppliers.

¶10. (SBU) After positing that the reactors under consideration are quite comparable to one another from technical and safety standpoints, Cserhati said that the decision will most likely be determined by financing arrangements and the preferences of the strategic investors. In a thinly veiled reference to the inclinations of the Russian and probably some of the European investors, he noted that "certain investors have clear preferences," adding that Fortum is the only company likely to base a decision purely on technical and commercial merits.

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...BUT THE REAL COMPETITION HAS ALREADY BEGUN

¶11. (C) In a recent telephone conversation, Gabe Pellathy, Manager for International Business Development at Westinghouse, indicated that the US firm's stiffest competition will come from the French and Russian firms. According to Pellathy, Westinghouse needs to win some European tenders early on in this current round of nuclear expansion projects or risk being excluded from the market. He says the French are doing "everything they can" to block the US from the European market and expects them to "play up the 'buy EU' angle" in their approach to the Hungarians. He added that E.ON and EDF would most likely support Areva, whereas RWE stands opposed to European monopolies and might give Westinghouse a fairer chance at the business. Atomstroyexport's advantage lies in the close relationship between the Hungarian and Russian governments as well as fact that engineers at Paks are already familiar with Russian reactor technology. Also helpful to the Russian bidder is that it will be able to offer the option to store spent fuel in Russia.

¶12. (C) Pellathy hopes Westinghouse's recent successes in outcompeting Areva and Atomstroyexport in China will bolster its case for the AP1000's technological superiority. He also notes that the Hungarian electric grid is more compatible with the Westinghouse design. With roughly one-third of its workforce located in the EU and potential financing partners that include RWE, Czech CEZ, Swedish Vattenfall, and Hungarian MOL, Westinghouse can also emphasize its own European credentials. Nonetheless, Pellathy recently informed the Embassy's Commercial Section that Westinghouse will soon be filing for advocacy in the Paks tender (company confidential, strictly protect).

¶13. (C) Comment: Diplomatic efforts on behalf of the potential vendors appear to have begun in earnest, and will likely intensify as the tender approaches. During our visit

to Paks, which we were hoping to tour, we hid our disappointment when Cserhati casually remarked that officials from the French Embassy had recently visited and taken a plant tour, after it was already apparent that we would not be offered one. Several local political contacts have also informed us of another round of Russian-Hungarian "intergovernmental meetings" to take place in Budapest on October 15-16. Given that energy cooperation has tended to feature prominently on the agenda of such gatherings in the past, it is almost certain that Russia's desire to participate in the Paks expansion will be a topic of discussion. With Westinghouse's impending application for commercial advocacy, Post, through its Commercial Section, looks forward to joining the fray. End comment.

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